COPY ORIGINAL

GTE Service Corporation
1850 M Street, N.W., Suite 1200
Washington, DC 20036
202 463-5200

EX PARTE OR LATE FILED

RECEIVED

NOV 18 1997

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

November 18, 1997

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
Washington, DC 20554

Re: *Ex Parte* - Foreign Participation in US Market (IB Docket No. 97-142)

Dear Mr. Caton:

In the October 23rd meeting that Rick Wolfe of GTE Communications Corporation and I had with Diane Cornell and Kathy O'Brien of the International Bureau, it was suggested that we describe the difference in the market for facilities based carriers and resellers.

The attached paper is a summary prepared in accordance with that suggestion.

Two copies of this notice are filed in accordance with Section 1.1206(a)(1) of the Commission's Rules.

Sincerely,

F. Gordon Maxson
Director - Regulatory Affairs

C: Diane Cornell
Kathy O'Brien
Karen Gulick

No. of Copies rec'd 012
List ABCDE

IS A PRICE SQUEEZE POSSIBLE WHEN AN INTERNATIONAL LONG DISTANCE RESELLER IS AFFILIATED WITH A FOREIGN TELEPHONE CARRIER?

DEFINITION & SUMMARY

A price squeeze occurs when a dominant firm that provides essential services reduces the market price of a competitive service and drives rivals out of the market. Under a price squeeze scenario, price-following competitors are driven from the market when the price reductions leave no margin to cover their costs.

A price squeeze is not possible for a long distance firm that resells services through an unaffiliated underlying carrier even though it is affiliated with a foreign telephone carrier for the following reasons:

- The charges paid by a reseller to the underlying facilities-based carrier are established in a contract. Charges by foreign affiliates to the underlying facilities-based carrier will simply be reflected in the contractual prices offered to resellers. The contract price may well be based on net settlement values, rather than strict accounting rates. In other words, where the underlying carrier may enjoy considerable return traffic (as noted below), there is an incentive to pass the some of the net settlement effect through to the reseller in order to obtain its business.

- A reseller which uses an unaffiliated underlying carrier does not receive the in-bound return traffic and revenues received by facilities-based carriers. In addition, a reseller's out-bound traffic to a foreign affiliate generates in-bound traffic and revenues for the underlying facilities-based carrier. The facilities-based carriers benefit from resellers that capture out-bound market share.

- A reseller – affiliated or otherwise – is probably not the price leader in the international long distance markets because resellers are substantially smaller than facilities-based carriers and simply do not have the same marketplace presence as facilities-based carriers. A reseller that reduces prices will not necessarily drive rivals out of the market because the dominant price-leading firms will not follow the reseller's price reductions. This effect can be seen from the data filed with the FCC by the facilities based carriers, in which smaller aggressive competitors have not appeared to affect the margins of the major carriers.

THE MECHANICS OF INTERNATIONAL RESALE

Broadly speaking, long distance carriers are either facilities-based or resellers. A facilities-based carrier owns and operates its own network facilities. A reseller contracts to buy services from a facilities-based carrier. Originating domestic access charges are paid by the facilities-based carrier to local telephone companies, and passed back to the reseller. The facilities-based carrier assesses a charge for transport over and through its network. The terminating international charges typically reflect the charges paid by the facilities-based carrier to a foreign terminating carrier. As noted above, the charges paid by the reseller are set by negotiation and contract with the facilities-based carrier.

Revenues realized by facilities-based long distance carriers depend on the balance and volume of in-bound and out-bound international traffic, and less so on the nominal level of international settlements and accounting rates. When facilities-based long distance carriers set their international rates, they do so by assessing the financial impact those out-bound rates will have on their in-bound and out-bound traffic. In contrast, a reseller who uses an unaffiliated underlying carrier does not receive in-bound traffic, and can only consider its out-bound costs. For example, when GTE Long Distance sets its international rates, those rates must cover the charges assessed by the underlying facilities-based carriers it uses, and be competitive with the rates offered by major international firms like AT&T. When AT&T sets its international rates, it considers its network costs, the termination costs in a foreign country, and the revenues it receives from foreign carriers for in-bound traffic.

Unless there is an increase in the total amount of traffic between the U.S. and the foreign country, it makes no difference which carrier originates the call, since the amount of settlement revenue received by the foreign carrier remains the same, and there is no net benefit to the corporation which has an interest in both the U.S. carrier and the foreign affiliate. For the traffic to grow, the reseller would have to engage in a massive and expensive marketing effort, which would be immediately apparent, particularly if the Commission has required advanced tariff notice and frequent traffic reports.

A price squeeze strategy depends on a dominant, price leader that provides essential services reducing its price to a level that competitors cannot match and cover the charges for the essential services. In instances involving long distance resellers, the reseller is typically much smaller than facilities-based carriers and cannot be the market price-leader. In the long distance market, GTE Long Distance serves about 1% of the total market, whereas AT&T serves more than half of the total market. AT&T does not set its prices by reference to GTE Long Distance. When GTE Long Distance sets its international rates, it must do so in competition with the price leaders